THE INTERNET AND THE CYBERSECURITIES MARKETPLACE

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I. Introduction.

A. Background: Information and Communication Capabilities of the Internet.

The Internet began in the 1960's as a decentralized, packet-switched network of computers funded by the Department of Defense, intended to facilitate communication in the United States in the event of a nuclear attack. In the late 1970's, universities and other nongovernmental entities started linking with the Department of Defense net. By the late 1980's there were multiple computer networks joined together in an "Internet." It allowed "e-mail" communications to be sent electronically over the Internet to one or more specific addresses, or even mass mailed, i.e., the message can be sent electronically to large numbers of addresses.

Among other Internet applications, the World Wide Web is the most popular. The World Wide Web consists of a vast network of Web "sites," i.e., graphical presentations of information that is controlled by the site-holder. Sites can contain pictures, text and sound in static or moving form. The World Wide Web brings together file transfer protocol, hypertext files, e-mail and other resources linked together on a global basis.

Other Internet applications important for disseminating information are the bulletin board and mailing list. The bulletin board (also called a "newsgroup"), unlike a Web site, is generally controlled by more than a single person. The bulletin board allows written messages, responses and new messages from a number of persons to be posted or downloaded from a given Internet location. The mailing list provides a way for network users who share interest in a given topic to exchange messages by sending a message to a central address where it is automatically rebroadcast to all other participants. Another capability relevant to securities transactions is "push" technology, which allows information to be sent through the Internet to pre-selected viewers automatically without the necessity of their logging on to a particular Web site or bulletin board.

The foregoing Internet applications, particularly the World Wide Web, create a dramatically new environment for both investors and companies issuing securities. Web sites, bulletin boards, e-mail and push technology can all be used in advertising, offering and selling securities and for disseminating investment advice. They permit communication instantaneously with millions of people worldwide at low cost. Internet communications can match proposed trades and circulate information in broad-based markets. They permit individuals to access massive amounts of more information far more quickly and directly than was believed possible just a few years ago. The speed and accessibility of Internet information permit potential buyers and sellers of securities to avoid traditional financial intermediaries and access each other almost instantly.

B. The Mushrooming Development of Securities Markets on the Internet.

In the mid-1990s, the marketing of securities on the Internet began to take off. In 1995 a micro-brewery called "Spring Street Brewing" was the first issuer to offer stock to the public directly online, by posting offering materials on its Web site. In early 1996, Spring Street Brewing generated widespread comment by an attempt to create a Web bulletin board for secondary trading in its stock; the financial press gave extensive coverage to the difficulties Spring Street encountered with the U.S. Securities and Exchange Commission. A number of small discount brokers started online secondary trading in 1995 and the number gradually swelled.

Developments in cyberfinance have virtually exploded since these early entries. Dozens of new Web sites have been introduced allowing dissemination of material on securities issuance, both for underwritten public offerings and direct public offerings conducted by issuers themselves. Electronic bulletin boards have been created for secondary trading directly among investors. Data banks containing names of potential investors for private, public and overseas offerings have been generated. The Web has increasingly become a hub for online trading through broker-dealers and dissemination of vast amounts of financial information by mutual funds and investment advisers.

The following overview of the cybersecurities marketplace explores how the Internet is being used for issuance of new securities, both publicly and privately, and for secondary trading in already-issued securities, and the implications of these uses for securities regulation. It also touches the jurisdictional issues involved in these electronic securities activities.

II. The Internet As A Means To Issue Securities.

A. Introductory.

Two main trends have developed involving issuance of new securities on the Internet. First, investment bankers can post their underwritings of stock issues on the World Wide Web to expose them to vast numbers of prospective investors at very low cost. Second, issuers can bypass traditional underwriters and make direct public offerings ("DPOs") of securities using the Web bulletin boards and push technology. DPOs thus far have typically involved modest amounts of capital sought essentially by small issuers, but the ease of creating Web sites will encourage the growth and maturity of the DPO as the digital marketplace evolves. The increased role of the Internet in facilitating issuance of securities has been accompanied by efforts of federal and state regulators to adapt existing rules to fit this dynamically changing marketplace.

B. Securities Regulation and Cybersecurities.

1. Federal Securities Regulation Framework.

The issuance of new securities is the primarily governed in the United States by the Securities Act of 1933 (the "1933 Act"). The 1933 Act generally requires registration with the Securities and Exchange Commission ("SEC") of securities that are publicly offered. The Securities Act of 1934 (the "1934 Act") generally requires registration of broker-dealers and national securities exchanges with the SEC. Both of these Acts regulate securities fraud, the 1933 Act focuses on securities issuance while the 1934 Act deals broadly with both issuance and after-market trading. Narrower in their coverage are the Investment Advisers Act of 1940 ("Advisers Act"), which generally affects investment advisers having $25 million or more under management or advising mutual funds, and the Investment Company Act of 1940 ("1940 Act"), which governs both open and closed-end investment companies that offer their securities to the public.

Since 1995, the SEC has sought by rule and interpretive release to mesh these Acts and the regulatory framework built up around them with the new Internet world. Its efforts have produced two October 1995 interpretive releases and a 1996 concept release, which constitute its principal guides to issuers and attorneys regarding delivery of information on securities by electronic means. The foregoing releases reflect an SEC effort to encourage electronic delivery of information to investors. At the same time, they also reflect a residual regulatory preference for paper delivery and a preference for directed Internet communication (e-mail) over Web site postings. The SEC has also published in 1998 an interpretive release on the application of U.S. federal securities laws to offshore offering and sales of securities and investment services over the World Wide Web.

a. Importance of Consent of the Recipient to Electronic Transmission of Information.

The SEC has analogized electronic distribution of information to the print medium, stating that it "would view information distributed through electronic means as satisfying the delivery or transmission requirements of the federal securities laws if such distribution results in the delivery to the intended recipients of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form." However, unlike information transmitted in paper form, an issuer must obtain the investor's informed consent to the receipt of information through the Internet. Moreover, the SEC makes such consent revocable at any reasonable time before electronic delivery of a particular document has actually commenced.

b. Importance of Timely Notice, Effective Access, and Reasonable Assurance of Delivery of Information.

Electronic disclosure of information must provide adequate and timely notice to investors, afford effective access to the information, and give reasonable assurance that the information in fact has been delivered. For example, merely posting a document on a Web site will not constitute adequate notice, absent evidence of actual delivery to the

investor. Separate notice by two paper methods--letter or postcard--or a directed Internet message (e-mail) can satisfy such actual delivery requirements. If an investor consents to electronic delivery of the final prospectus for a public offering by means of a Web site, but does not provide an electronic mail address, the issuer may post its final prospectus on the site and mail the investor a notice of the location of the prospectus on the Web along with the paper confirmation of the sale.

It is also necessary that investors have access to required disclosure that is "comparable" to postal mail and that the investor must have the opportunity to retain the information or have ongoing access equivalent to personal retention. A document posted on the Internet or made available through an on-line service should remain accessible for so long as any delivery requirement under SEC rules applies. If a preliminary prospectus is posted on a Web site, it should be updated "to the same degree as paper."

The SEC requires issuers to make paper versions of their documents available where there is computer incompatibility or computer system failure or where consent to receive documents electronically is revoked by the investor. Issuers should have reasonable assurance, akin to that found in postal mail, that the electronic delivery of information requirement is satisfied. The delivery requirements can be satisfied by the investor's informed consent to receive information through a particular electronic medium coupled with proper notice of access. Sufficient evidence of delivery can also include an electronic mail return receipt or confirmation that a document has been accessed, downloaded or printed; the investor's receipt of transmission by fax; the investor's accessing by hyperlink of a required document; and the investor's use of forms or other material that are available only by accessing the document.

2. State Regulation of Securities.

The role of the states in the issuance of securities has shifted in the past few years for reasons having nothing to do with the Internet. When an issuer is listed or authorized for listing on the New York Stock Exchange or American Stock Exchange, or is included or qualified for inclusion in the Nasdaq National Market System, the states play a diminished role, since their ability to require registration of such securities at the state level has been largely preempted by Congress. Congress has also preempted state regulation of those security issuances which are exempt from 1933 Act registration by virtue of SEC exemptions adopted pursuant to Section 4(2) of the 1933 Act (the exemption for private offerings). In effect, this deprives the states of authority over private placements, including those made in reliance on SEC Rule 506 in Regulation D. However, the states have retained authority to regulate most other kinds of exempt small offerings, particularly those under SEC Rules 504 and 505. Moreover, states retain authority to regulate broker-dealers within their jurisdiction, notwithstanding the 1934 Act.

Application of state "blue-sky" law is traditionally based on location, i.e., the laws of a given state seek to regulate transactions occurring within the state's boundaries. Section

414(a) of the Uniform Securities Act ("USA") thus provides that its jurisdiction reaches all persons offering or selling securities when "(1) an offer to sell is made in this state, or (2) an offer to buy is made and accepted in this state." As discussed later in more detail, "in" and "within" raise new jurisdictional issues in the online offer and sale of securities, since anyone in the world with a PC and modem can access a Web site on which a securities offering is posted.25ANOTE: THIS IS FOOTNOTE 25A & 25B IN "SUPERSCRIPT" FONT SIZE. PER DTR'S REQUEST TO CREATE A FOOTNOTE 25A & 25B AND IT WILL APPEAR INSIDE FOOTNOTE NO. 25 IN "SUPERSCRIPT" FONT SIZE WITH TEXT. kar 4/1/98.

The states have sought to further marketing on the Wed by creating jurisdictional safe harbors.25B However, the state regulators have not yet adopted separate rules or interpretations dealing with what kind of electronic delivery will satisfy existing disclosure requirements under their blue-sky laws.

C. Public Offerings of Securities on the Web.

1. Underwritten Offerings.

a. Regulatory Considerations.

Apart from liberalized notice, access and delivery requirements (discussed above in subsection II.B), a securities offering in cyberspace is still an offering subject to the regulatory scheme that predates the advent of the Internet. For example, if an offering is required to be registered under the 1933 Act, there is a ban on publicity that might condition the market, such as publication of bullish information on the issuer's Web site. Moreover, the issuer or underwriter must not violate "quiet period" restrictions by hyperlinking a preliminary prospectus to research reports or other information that are not found in the registration statement. Once the registration statement is filed with the SEC, however, there are no restrictions on oral offers other than normal antifraud restrictions.

After the registration statement becomes effective, the Web site containing the final version of the prospectus can be hyperlinked to other sales literature. In fact, the issuer or underwriter can mail sales literature to persons for whom delivery of the prospectus via the Web site was effective, so long as notice of the availability of the final prospectus and its Web site location accompany or precede the sales literature.

Underwritten offerings that use the Web for publicity will be typically filed on SEC Form S-1, S-2 or S-3, and hence will be exempt from qualifying under state blue-sky statutes. However, state qualification is required where the offering is made by means of the Regulation A ("Reg A") exemption from 1933 Act registration or by a "small business issuer" on SEC Forms SB-1 or SB-2. Many Web-based DPOs are for $1 million or less, which exempt from registration under the 1933 Act but must still generally qualify under the blue-sky laws of states where the securities are offered and sold.

b. Examples of Firm Commitment Underwritings on the Web.

The first online posting of a conventional firm commitment underwriting occurred in 1996, when Solomon Brothers created an Internet site for the initial public offering of Berkshire Hathaway's new Class B stock. In the Berkshire Hathaway offering, the prospectus itself could not been seen on the Web site; it was only obtainable by contacting the underwriters. The subsequent public offering of common stock of Yahoo!, the Web search engine, in August 1996, allowed the viewer to download the Yahoo! prospectus directly from the Web site. However, orders for shares could only be placed by contacting the underwriters by phone or mail or through another broker-dealer. The same year, the regional firm ABN Amro Chicago Corp. led a syndicate which posted $500 million of GMAC's "Smart Notes" on ABN Amro's Web site (www.direct-notes.com). As with Berkshire Hathaway, the prospectus for the GMAC notes could not be directly downloaded. Instead, the viewer had to fill in his or her name and address on-screen and request that a prospectus be mailed.

c. Development of "Roadshows" on the Internet.

Beginning in 1997, the SEC opened the door for underwriters and issuers to conduct public offering "roadshows" over the Internet. A traditional roadshow involves presentations made by the issuer and its underwriters to large investors, institutions and analysts. The roadshow conducted between the filing of a registration statement with the SEC and the time the registration becomes effective. In the presentations, the issuer's management and the underwriters explain the issuer's business and industry as well as the offerings and respond to questions.

The Internet raises several unique roadshow issues. The 1933 Act prohibits the transmission of any "prospectus" relating to a security being publicly offered unless it is the same preliminary prospectus as filed with the SEC. "Prospectus," a term of art in the 1933 Act, is broadly defined to include any "prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security." Accordingly, no written material could be distributed in a traditional "oral" roadshow other than copies of the preliminary prospectus. The question arises as to whether an electronic "roadshow" is like a written, radio or television communication and hence an impermissible "prospectus" under the 1933 Act. Through a series of no-action letters, the SEC has carved out an interpretation of "prospectus" that allows virtual roadshows to be legally conducted.

First, in March 1997, the SEC agreed to take no action against closed-circuit video roadshows, so long as they were transmitted solely to subscribers who consist principally of registered broker-dealers and investment advisors and all of whom would receive a copy of the preliminary prospectus before receiving the video transmission. In so doing, SEC agreed with the position that because no written material was to be generated in the transmission, only pictures and oral presentations, no "prospectus" would be involved. The same rationale was at the core of another SEC position in September, 1997, allowing public offering roadshows by Internet. The SEC agreed that such a virtual roadshow would not constitute a 1933 Act "prospectus" where the following format was used:

(1) A Web site for roadshows regarding public offerings would be established, with a posted index of those available for viewing by qualified investors and by the underwriting investment banks. The roadshows would be indexed by offering company, underwriter and industry classification.

(2) To view an online roadshow, a qualified investor would be required to contact an institutional salesman or the syndicate department at one of the underwriters. The qualified investors would be typical of those customarily invited to attend live roadshows (e.g., registered broker/dealers and investment advisers). An access code be required to view the roadshow on the Internet, a log would be maintained of who specifically received the access code. The access code for each roadshow is changed each day and each qualified investor will be allowed to view a roadshow one day only.

(3) The Internet roadshow would be exactly the same as the live show. The live roadshow would be filmed in its entirety, including the filming of all questions and answers. The Internet version of the roadshow would present the charts and oral presentation at a similar speed as the live roadshow.

(4) A large and obvious button reading "PRELIMINARY PROSPECTUS" would be continuously displayed throughout the roadshow. A viewer would simply click on the button to access the preliminary prospectus on file with the Commission to view it in its entirety.

(5) Before accessing the roadshow, a potential viewer would be required to agree to a broad disclaimer and statement to the effect that copying, downloading or distribution of the material is not permitted, that the roadshow does not constitute a prospectus and disclaim any regulatory approval in a manner similar to a preliminary prospectus.

(6) The viewer would be informed by a periodic crawl across the screen or by prominent text of the importance of viewing the filed prospectus, which is available by clicking a button the screen.

In late 1997, another Internet roadshow producer, the online investment news service Bloomberg, has gained SEC permission for its presentations. The Bloomberg presentations would also limit access to persons who have been authorized by the underwriters to view the roadshow. The difference in Bloomberg's roadshow from that of Net Roadshow lies in its simultaneous broadcast: the viewer can participate in the roadshow presentation on an interactive basis by sending questions which are fielded by an online monitor who can present the question to representatives of the issuer. This moves a step beyond the rebroadcast that occurs in earlier online roadshows. In the Bloomberg roadshow, the preliminary prospectus can be called up on the viewer's screen or downloaded at any time.

Because roadshows traditionally have not been available to average investors, but only to securities professionals and sophisticated investors, the initial impact of Web-based presentations will probably be to reduce the number of locations where such live presentations are made, thereby saving expenses of the issuer. However, the ready availability of roadshows, coupled with the increased availability of financial information and analysis to the individual investor (Section IV, infra) raise the question whether it makes regulatory sense any longer to deny the individual investor the ability to "attend" a virtual roadshow. To restrict the type of information available at a roadshow, which consists of more recent information and projections not contained in the prospectus, to the more affluent and powerful investor is not necessarily good regulation. This may change as the Internet evolves further. One venture firm was reported in March, 1998 as prepared to seek a no-action letter from the SEC that would allow retail investors access to roadshows via the Internet.

2. Direct Public Offerings ("DPOs").

As discussed earlier, a DPO involves an offering without a broker-dealer intermediary; instead, the issuer sells its own securities directly to investors. It is in effect a "best-efforts" offering made by the issuer itself. The DPO will typically involve an escrow into which the proceeds from a minimum level of sales must be deposited in order for any funds to be released to the issuer. Direct offerings have been around for many years before the Internet, although only a relatively small number were made. The World Wide Web is changing the DPO landscape because it enables the issuer to access so many potential investors so rapidly. Dozens of sites for DPOs on the World Wide Web--most of them put up since mid-1996--demonstrate the online approach to corporate finance.

a. Regulatory Considerations.

Most DPOs on the Web have used Form 1-A under SEC Reg. A which provides an exemption from full-blown registration for stock offerings that do not exceed $5 million, or a state securities form available for issuers which do not seek over $1 million. The state form, U-7, has been approved by the North American Securities Administrators Association ("NASAA") and is called the Small Corporate Offerings Registration or "SCOR" form. It is a 50 question form designed to be understood by the lay person, and is accepted in every state except Alabama, Delaware, Hawaii and Nebraska.

Offerings on Form U-7 are exempt from SEC registration by virtue of SEC Rule 504. However, states impose various requirements on use of U-7 for offers within their jurisdiction. For instance, some states require that the issuer have equity capital of a certain percentage of the total capital being raised. Most states limit the costs and expenses of originating the capital and require audited financial statements for offerings over $500,000. The SCOR form can also be used as part of a Reg. A filing, and some listing services on the Web require that listing companies which file under Reg. A incorporate the SCOR form.

b. Examples of DPOs.

An early Reg. A DPO was located on the Web site of "IPO DataSystems" (www.ipodata.com/dpo.html). The issuer, "Interactive Holdings Corporation" (www.thevine.com/ihchome.htm), sought to sell its own stock directly by allowing the downloading of an offering circular and a subscription agreement. The offering circular on the Web site, however, was not the "official offering circular" filed with the SEC. That document had to be obtained by request made via fax, phone, e-mail or regular mail. Other DPO sites, such as that for "Pyromid Inc.," allow the offering document to be viewed online and downloaded by the viewer (www.pyromid.com/pyromid/offcirc.html). Pyromid makes what it calls "technologically advanced" portable outdoor cooking systems for campers, hikers and other outdoor enthusiasts, and its Reg. A offering circular covered a minimum-maximum best efforts offering between about $3 million to $5 million.

Another site that allowed direct downloading was at the address of Dechtar Direct, Inc. ("DDI" at www.dechtar.com). DDI's prospectus, placed on the Web in February 1997, stated that it is the "largest advertising company in North America specializing in the adult entertainment and adult mail-order industries." Among its services are providing catalog lead generation and response services. DDI's offering was the first Web DPO to combine a secondary offering of already outstanding shares by selling stockholders with new shares offered by the issuer. Its offering was also unusual because it was done by means of a registration statement on SEC Form SB-2, rather than using one of the exemptions such as Reg. A or Form U-7. Form SB-2 had to be used because the foregoing exemptions are not available for secondary sales by existing stockholders.

A Web-posted DPO must take steps to avoid problems under state blue-sky laws. If an offering document can be read and downloaded directly at the site, the issuer should install a "screen" to prevent making offers to residents of those states in which the offering has not been qualified. This procedure allows the offering to meet the states' blue-sky exemption discussed in subsection V.B. below. At DDI's site, for example, the viewer is presented with a screen that lists all 50 states as well as various foreign countries. The viewer first clicks in the state of residence from this list, and access to the prospectus and subscription material is only granted if the offering has been qualified in that state.

To the extent success in a DPO is defined as reaching the minimum amount of sales required to close escrow, to date a minority of all DPOs have achieved success. Even fewer have sold the maximum amount of a minimum-maximum range. Perhaps the most ambitious DPO to date is the $100 million offering of Technology Funding Venture Capital Fund VI, LLC ("Tech Funding") (www.techfunding.com). Tech Funding also linked its site to the Direct Stock Market, one of the interface sites between DPO issuers and investors discussed below and its prospectus located on the SEC's EDGAR database (www. sec.gov/Archives/edgar/). Tech Funding filed on Form N-2, using a wholly-owned broker-dealer subsidiary to assist in the offering without being paid any sales commission, and its registration became effective in December 1997. Unlike most other DPO issuers, Tech Funding is not seeking to develop a public or secondary market for its

shares. Instead, share transfer will be subject to the control of the Fund managers. The Fund will be a nondiversified investment company under the 1940 Act.

It is too early to forecast the extent to which the World Wide Web will be a ubiquitous tool for public offerings at all levels of the market, but some commentators believe that the base must be broadened and the number of households with Internet connection substantially increased in order to support general securities offerings. The prospective Web investor will quickly discover that a substantial proportion of the companies using the Web to offer their securities are in some phase of consumer goods or services, whether beer, health products, or outdoor cooking devices. These are probably the kinds of issuers that have the best chance to succeed with DPOs, because they already have some built-in "constituency" of consumers who are familiar with their products and therefore might be receptive to their stock. DPO issuers who start with just a new product or technology, in contrast, are in a weaker position so far as reaching potential investors. This deficiency may be cured as we see increased number of Web sites that develop databases of potential investors to whom such issuers can direct their solicitations. Over time, we can expect to see such investor groups divided and subdivided accordingly to the types of industries they like. This will allow more "targeting" in the DPO process.

c. Sites Providing Interaccess Between Groups of Potential Investors and a Number of DPOs.

Even though DPOs do not use traditional underwriters, they have spawned a new type of financial intermediary. The new model is a Web site designed to develop databases of potential investors in new stock offerings which can be linked on site to new DPOs. For example, "Internet Capital Exchange" (www.inetcapital.com/), operated by Internet Capital Corp. ("ICC 1"), was one of the first Web startups to attempt to connect various DPO issuers with potential investors. To register with ICC 1's "exchange," a viewer would be required to first fill out a questionnaire giving certain personal information. Completion of the questionnaire would allow access to the "Roadmap to a Direct IPO," which would include a description of SEC forms suitable for public offerings of newer and emerging companies. Upon completing personal registration, the participant would be entitled to be notified by e-mail of new offerings which are legally offered in the viewer's state of residence. The Internet Capital Exchange system for secondary trading of already-issued securities was to be based on its bulletin board. Access to the board would permit the participant to find posted sell offers, select one to accept, or post the viewer's own offer to buy.

Internet Capital Exchange initially offered its service without any SEC clearance. It disclaimed on its Web site being a broker/dealer, investment advisor, or being registered with the SEC or any state blue-sky agency, and disclaimed having evaluated or investigated any company listed on the site or endorsing any such company. Nevertheless, its assured its audience that modern technology is creating fantastic opportunities "to realize the American dream of success and independence" and that Internet Capital is "bringing these opportunities directly to you."

The SEC then stepped in and informed ICC 1 that it could not operate the bulletin board until it requested a no-action letter, feeling the site would be involved in active solicitation and conducting business as an underwriter. In its subsequent request for a no-action letter from the SEC, ICC 1 laid down a number of operating conditions:

(1) It would charge only a flat fee, not contingent upon the success of the offering, to issuers to provide a Web site for facilitating the issuer's online securities offering.

(2) ICC 1's service would be provided for issuers of registered offerings as well as Reg. A and SCOR offerings. ICC 1 would not provide this service for securities to be issued pursuant to Rule 505 or 506 of the Act.

(3) ICC 1's Web site would support a grouping of individual corporate bulletin board areas or "corporate listings." An individual logged on to the site could elect to visit any corporate bulletin board area where a tombstone, preliminary offering document, or final offering document can be viewed regarding a specific company. Each corporate bulletin board area would remain autonomous and operate separately from all of the other corporate areas; only offerings and information pertaining to that specific corporation would be displayed in its bulletin board area.

(4) "Tombstone" advertisements on the site would meet the requirements of SEC Rule 134, and the red herring prospectus would meet the requirements of SEC Rule 430. Such "tombstone" advertisements and the red herring prospectus would set forth the names of the issuers.

(5) The distribution of the "tombstone" advertisement and the red herring prospectus would be in accordance with Release 33-7233. There would be no "hot links" between the Web site and any other corporate marketing information or a corporation's home page.

(6) The order in which issuers were to be displayed within ICC 1's site would be determined by objective criteria (either alphabetically by name of issuer, or sequential by date of listing). A disclaimer will state that the order of presentation in no way constitutes any judgment by ICC as to the merits of a particular offering. The site would link to any "tombstone" advertisement or any red herring prospectus the disclaimers required under SEC Rule 134(b)(1) and (d), respectively.

(7) Once an issuer were to receive notice that its registration is effective, ICC 1 would post the final offering document on its Web site. Only the final offering document will contain the subscription documents necessary to purchase the offered securities.

(8) The Web site would contain a disclaimer that ICC 1 is an underwriter of the securities or is acting as a broker-dealer or agent of the issuer, and in fact would not function as an underwriter or a broker/dealer, but merely act as a delivery mechanism for an issuer.

(9) ICC 1 would not receive any commission nor take compensation of any kind based on the sale of any securities. Instead, its one-time flat fee (the "Listing Fee") would cover such items as development of the software, use of the software platform, design and graphics work and technical consulting regarding the listing and access to the ICC 1 system. The Listing Fee would be independent of the number of hits to the Web Site after listing, or success of the offering.

(10) ICC 1 would not receive, transfer, or hold funds or securities, nor provide information of any nature regarding the advisability of buying or selling securities.

(11) A viewer seeking to access ICC 1's corporate listing areas would first have to go through a registration process involving disclosure of key information about the viewer and issuance of a selected log-on name and password required for required for further access to the Web site.

(12) Viewers would be given the opportunity to download a prospectus electronically or request that the issuer deliver a printed copy of the prospectus, and ICC 1 would have no contractual liability for improper prospectus delivery. Instructions for sending the proper funds and subscription information to the issuer or its agent will be contained in the prospectus. Subscription agreements would be included in the file delivered with the prospectus. No subscription agreements could be accessed without delivery of a prospectus.

(13) After electronic delivery of a prospectus, ICC 1 would have no further involvement in the transaction, such as negotiations regarding prospective purchases, record keeping of completed transactions or any reporting requirements of the issuer.

(14) ICC 1's Web site would be structured so as to preclude any solicitation or viewing of an offering document by persons in states where the securities were not qualified for sale.

Based on the foregoing methods and procedures described, the SEC said it would not require ICC 1 to register as a broker-dealer pursuant to Section 15(b) of the 1934 Act. The SEC specifically expressed no view on whether ICC 1 would be acting as an "underwriter" within the meaning of the 1933 Act nor whether the prospectus delivery procedures described in ICC's letter satisfy the standards previously articulated by the SEC in the October Releases and Release 7288.

Another firm proposing an even more extensive role in DPOs over the Internet is First Internet Capital Corp. ("INTERCAP" at www.1stcap.com). As of early 1998, INTERCAP claimed to offer "a fully integrated range of services necessary for a company to go public over the Internet via a Reg. A offering. Among services described on its Web site were:

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(1) Conducting initial due diligence.

(2) Drafting offering materials.

(3) "Making available at a package price a highly competent securities attorney" to review and file the offering with the SEC, and to provide "follow-up" until the offering is cleared.

(4) "Making available, at the best price possible, a Big 6 accounting firm" to audit the issuer.

(5) Providing escrow and stock transfer services of Huntington National Bank "on a negotiated package basis."

(6) "Direct access" to INTERCAP's list of interested investors.

(7) Promoting and advertising the issuer's offering over the Internet.

For the foregoing services, INTERCAP said it would receive unspecified cash, a "moderate contingent fee" to be paid from the proceeds of the offering, plus a "small percentage of the company's stock."

Because it was to receive contingent compensation for, among other activities, "due diligence" and "promoting and advertising" the offering, INTERCAP would appear to fall within the statutory definition of an underwriter under the 1933 Act. Whether it has yet applied to the SEC for a no-action letter is not known (an online search of posted no-action letters did not locate any for INTERCAP). INTERCAP may be exposing itself to possible liability for any failings on the part of attorneys whom it "makes available [to issuers] at a package price." Indeed, the attorneys themselves could encounter sticky conflict of interest issues in view of the way they are planned to be brought into the DPO transactions.

Another firm that announced plans to deliver DPO prospectuses to potential investors is Virtual Wall Street (www.virtualwallstreet.com). In early 1998, Virtual Wall Street reportedly was negotiating an alliance with Standard & Poor's. It plans to offer prospective investors due diligence on DPO issuers. The potential liability undertaken by Virtual Wall Street to Web investors in offering due diligence on thinly-capitalized issuers is difficult to predict, because liability would be affected by whatever cautionary language, disclaimers and waivers can be built into the Web site and made legally effective on investors. In any event, Virtual Wall Street said it would seek its own no-action letter from the SEC, stating that it is reluctant to rely on the ICC 1 letter.

Some Web sites are less proactive, and simply provide centralized links to DPO issuers without additional services such as databases of investors. The utility and potential profitability of such sites is dubious, because the linking service offered is narrow, and there are better ways to access DPOs. Few of these limited sites have lasted long with

such limited services. For example, in 1996 a viewer could have logged on to "SCORnet" (scor-net.com) to find lists of issuers who filed using Form U-7, SEC Reg. A or who had registered on SEC Form SB-2. "SCORnet" also contained a list of prospectuses of a number of issuers listed by state. However, in June 1997 SCORnet was merged into "Direct Stock Market Incorporated," with its Web address changed (www.directstockmarket.com). Direct Stock Market as of early 1998 was hosting electronic road shows and seminars (in which "full streaming video and audio" could be presented together with presentations by issuers while taking questions from the audience through a chat window), and lists public and private offerings which are accessible on-line only by registered viewers. It uses "push" technology to send notices of new public and private offerings to its subscribers. It says it has requested a no-action letter from the SEC to allow it to operate an electronic bulletin board for secondary transactions.

D. Nonpublic Internet Offerings.

The notion that the World Wide Web can provide a home for private placements exempt from 1933 Act registration may at first sound counter-intuitive. However, there is no reason that the Internet should be an impossible arena for private placements simply because of its global reach. If that potential reach can be in fact limited to a discrete group of sophisticated investors by screening and monitoring technology, the group would be akin to a small restricted club located inside a giant hotel. The SEC has for over a decade sanctioned the use of the Reg. D private offering exemption by pre-qualification of groups of accredited investors who would respond to extensive solicitations by furnishing extensive financial data. In a similar vein, the SEC has taken the position that the pre-qualification of a number of accredited or sophisticated investors on a Web site and electronically notifying them in a secured manner of subsequent private placements would not involve a "general solicitation," and therefore would allow the building of investor data-banks for private offerings under SEC Regulation D.NOTE: THIS IS FOOTNOTE 56 & 56A IN "SUPERSCRIPT" FONT SIZE. PER DTR'S REQUEST TO CREATE A FOOTNOTE 56A AND IT WILL APPEAR INSIDE FOOTNOTE NO. 56 IN "SUPERSCRIPT" FONT SIZE WITH TEXT. kar 4/1/98.

An early example of an investor data bank is "IPOnet" (www.zanax.com/iponet), which has billed itself as "the only Internet site cleared by the United States Securities and Exchange Commission to sell new Public and Private securities online." This is partly true, since IPOnet did receive a no-action letter with respect to IPOnet's method of facilitating private offerings under Reg. D.56A However, IPOnet was not alone in obtaining SEC authorization for an investor data bank for private placement.

Under the SEC's no-action letter, IPOnet's site can post notices of Reg. D offerings which only the accredited investors could access. IPOnet identifies four distinct investor types, primarily based upon availability of applicable exemptions under the securities laws, i.e., "General Member," "Accredited Investor," "Sophisticated Investor," and "Foreign Investor." Virtually anyone can apply for the category of General Member. A General

Member receives an e-mail notice in turn every time IPOnet posts a new offering. The e-mail notice will be hot-linked to an announcement on the Web site. Only certain viewers can qualify as an Accredited Investor. IPOnet requires completion of an "Accredited Investor Questionnaire" to determine whether the person meets the standards for participation in a non-public offering under federal or state exemptions. Instead of income or net worth tests of the type required for accredited investors, a Sophisticated Investor must have a history of venture capital and restricted investments. Finally, to qualify as a Foreign Investor, a viewer must show facts sufficient to establish identity as a non-U.S. resident. The intention here is to establish a database of persons who might be eligible to participate in an offshore offering under SEC Regulation S.

IPOnet also provides for the sale of securities to viewers through an affiliated NASD member firm. Once an IPOnet viewer opens a participating brokerage account with the NASD firm, he or she may make "electronic indications of interest" directly through the Web site. This allows the viewer to purchase publicly offered securities by electronic confirmation of their purchases on the effective date. No IPOnet member can obtain access to private placements or private placement memoranda except by completing either the Accredited, Sophisticated or Foreign Investor questionnaires.

Over a year after IPOnet began operating, a non-profit entity called Angel Capital Electronic Network approached the SEC with the concept of a Web listing service that would be operated by a group of educational institutions and other non-profits. Like IPOnet, Angel Capital represented that it planned to list on its homepage small offerings exempt from registration under either Reg. A or SEC Rule 504. It would only allow "accredited Investors" meeting the criteria of Reg. D to participate would have to register on the Web site in order to access an offering circular in Form U-7. "Solicitation of interest" documents by which issuers could "test the waters" for an offering pursuant to Reg. A would also be listed. To register as an "accredited investor" and receive a password to access Reg. D private placements, a viewer would be required to certify to financial and other qualifications necessary to accredited investor status. If such an accredited investor wished to purchase stock of a small company listed on the site, the investor would contact the issuer directly. Angel Capital represented that no trading would take place on the "network" operated by the member institutions, and no employee of the site would participate in any sales transaction. However, accredited investors would be able to use a search engine within the Web site to help find the types of companies in which they would be interested. The search engine would also be able to notify an investor via the Internet if a company that listed its securities on the site has characteristics that would correlate to that particular investor's interests. The SEC determined that the Angel Capital group would not have to register as a broker-dealer or as a national securities exchange.

NOTE: THIS IS FOOTNOTE 61 & 61A IN "SUPERSCRIPT" FONT SIZE. PER DTR'S REQUEST TO CREATE A FOOTNOTE 61A AND IT WILL APPEAR INSIDE FOOTNOTE NO. 61 IN "SUPERSCRIPT" FONT SIZE WITH TEXT. kar 4/1/98.

As of February 1998, Angel Capital Electronic Network had gone online with the home page acronym "ACE-Net" (ace-net.sr.unh.edu). The site provides online questionnaires for both prospective investors and prospective issuers. The latter must use a SCOR or U-7 Form for either a Rule 504 or a Reg. A offering (with additional requirements on the case of Reg. A).

Another example of a site generating a data bank of potential investors for exempt securities offerings, including private placements, is "INVBank" (www.invbank.com/). INVBank aims to help issuers involved in both private and public exempt transactions contact appropriate persons in its data base. It lets viewers register at one or both of two levels: (1) "SAVVY INVESTOR," or (2) member of the "INVestor's CIRCLE for Accredited Investors." The INVestor's CIRCLE is limited to those who would qualify as "accredited investors" under Regulation D. Their registration allows them to occupy a position in INVBank's "Private Placement Arena" and review various Reg. D offerings. A SAVVY INVESTOR does not have to meet the qualifications of an accredited investor. The SAVVY INVESTOR is able to access a list of companies planning to make public offerings and allowed to give any company feedback and to submit indications of interest. By clicking a link to any such issuer, the SAVVY INVESTOR receives a short and bullish description of the issuer's business.

The same principles that allowed building a secured base of accredited investors for IPOnet have been invoked in the case of private investment funds: If a fund were deemed to be making a public offering on the Internet, it would not only be subject to registration of the offering under the 1933 Act, but would have to register as an investment company under the 1940 Act. The SEC in a no-action letter agreed that an operator could post information regarding funds on a home page and other linked pages on the World Wide Web that is password-protected and accessible only to subscribers who are predetermined by the operator to be accredited investors. The private funds could post descriptive information and performance data on the site. There would be a 30-day wait after an investor became qualified before he would be allowed to purchase securities in a hedge 61A fund.

Another form of exempt offering is one pursuant to SEC Rule 144A. Rule 144A facilitates a private placement of debt securities by a U.S. issuer (or equity or debt securities of a foreign issuer traded offshore by allowing securities that are sold to "qualified institutional buyers" (such as pension and mutual funds with at least $100 million under management or broker-dealers with at least a $10 million securities portfolio) to be exempt from registering the securities under the 1933 Act even though the securities are resold quickly to other qualified institutional buyers. Because there are no holding periods required as among such purchasers, the Rule 144A market takes on certain aspects of a public market, and Rule 144A offerings are in some ways similar to public offerings, with preliminary offering memoranda being circulated to purchasers and "roadshows" often conducted before the offering material is finalized. Such roadshow-type presentations to sophisticated investors have been a marketing tool under Rule 144A.

In January 1988 the SEC pushed the Internet envelope further out by allowing roadshows for offerings made under Rule 144A. The SEC's no-action position was conditioned on the issuer taking each of the following steps: (1) denying access to its Web site for viewing of a particular road show to all persons or entities, except those institutions for which the seller has confirmed its reasonable belief regarding their qualified institutional buyer status; (2) assigning confidential passwords to each qualified institutional buyer which will be unique to a specific road show, and expire no later than the date of termination of the related offering; (3) receiving confirmation from each seller that such seller is a qualified institutional buyer within the meaning of Rule 144A(a)(1), there exists an adequate basis for such seller's representations of its "reasonable belief" that each entity to which it has assigned a confidential password is a qualified institutional buyer, and the offering to which the particular road show relates is not subject to registration under the 1933 Act; (4) having no actual knowledge, or reason to believe, that a seller is not a qualified institutional buyer, any of the entities to which the seller has assigned a confidential password is not a qualified institutional buyer or the securities offering to which a particular road show relates is subject to registration under the 1933 Act; and (5) not being an affiliate of any seller or issuer of a security that is the subject of a particular road show.

Additional Internet use by large and sophisticated institutions involves the paperless syndication of loans by groups of lenders. IntraLinks, Inc. (www.intralinx.com) is a New York-based firm operating networks that bring together large financial institutions, using Lotus Notes technology and security and encryption protocols. The issuer pays a fee to have information on a specific loan transaction posted. Access is free to investors. Banks who are chosen for a loan syndication receive a password and user identification that enable them to log onto the lead bank's page at the IntraLinks site. They can access details of a syndication in real time. Royal Bank of Canada led one of the first "cyber-syndications in early 1996. Bank of America took the Internet loan syndication one step further in September 1997 when it used IntraLinks to syndicate a refinancing of National Semiconductor. Unlike prior loan syndications which used IntraLinks on the Internet alongside traditional paper syndication systems and paper documentation, the National Semiconductor deal was paperless. It was syndicated entirely over the electronic service.

III. Secondary Trading of Securities in Cyberspace.

A. Retail Trading by Broker-Dealers.

Even before it was used for offerings of securities, the Internet had begun developing a new dimension for secondary trading in already-issued securities. Small discount brokerage firms were the first to offer full online trading services and research to account holders in 1995. By October 1996, investors checked stock prices electronically and obtained other information from the NASD Web site 2.1 million times in just one day. It was estimated that in 1966, there were 1.5 million online accounts, almost double a prediction made in late 1994. In 1997, the number had grown to almost three million, and

the number is expected to be 14 million by 2002. Internet-based trading accounted for 17% of total retail sales in 1997 according to one survey, with that figure expected to increase to 30% by the end of 1998. Fifty-two brokers were offering some form of electronic trading in early 1998. These include E-Trade and Charles Schwab & Co., which offers full-service cyberbrokerage through its StreetSmart and other systems. As of March 1997, Schwab had 700,000 active on-line accounts and $50 billion in on-line customer assets, and by December 1997, Schwab's sales by means of electronic trading for the month for the first time were more than half the firm's total retail sales. Assets managed by on-line investors will grow from over $100 billion today to $524 billion in 2001 and account for more than 8% of the total assets held by small investors. Apart from actual trading in securities, the Boston Consulting Group predicts that firms with institutional clients will perform increasingly complex analysis and create increasingly complex financial instruments.

Online trading allows investors to have access to their portfolios 24 hours a day and to place orders anytime. Online brokers provide news and stories about the investor's portfolio holdings, free quotes on stocks, bonds, and mutual funds, some even send an e-mail at the end of the day with closing quotes for an entire portfolio. A spur to online brokerage has been the proliferation of links between broker-dealers and other Web-based services. For example, the Web site of the newspaper USA Today, from its "Marketplace" page (www.usatoday.com/marketpl/finan.htm), gives viewers direct links to six on-line brokerages such as E*Trade and Accutrade. USA Today receives a fee for each order received by the brokerage firms.

Arguably, USA Today might fall within the definition of a "broker" under the Securities Exchange Act of 1934 ("1934 Act") and be required to be registered as such. However, under an SEC no-action position taken in late 1966, online access services such as America Online or CompuServe have been allowed to connect viewers to broker-dealers without registration as broker-dealers, even though they receive a flat fee for each order transmitted through an icon on their Website menus to licensed broker-dealers, so long as certain conditions are met. Viewers may use the access service or link to reach a licensed broker-dealer by clicking an icon and then open a brokerage account, but the access provider must not take any part in the licensed broker-dealer's services other than by routing messages. Moreover, such access providers must not to handle any customer funds or securities, effect clearance of trades or extend credit to any customer in connection with a purchase of securities. The "nominal" flat fee paid by the broker-dealer to the online access service for each order transmitted may not vary depending upon the number of shares, value of the securities involved or the successful execution of the trade.

In addition to its USA Today link, E*Trade and four other large on-line brokers, including Fidelity Investments and Schwab, are linked to the "Microsoft Investor" Web site (http://investor.msn.com/hom.asp?newquid=1$). Seventy-five broker-dealer firms were offering services on the World Wide Web as of early 1998 through links between their Web sites and a giant cybersecurities mall known as "Stockhouse" (www.stockhouse.com). Stockhouse, a highly robust site, not only links the viewer to brokerage firms with web addresses, but also provides links with 51 stock markets around

the world. These include the New York and American Stock exchanges, Nasdaq, and major foreign markets such as the London, Tokyo, Korea, Madrid, Oslo, Paris and Frankfurt exchanges.

Full-service brokerage firms acknowledged the potentialities of the Web in December 1996, when Dean Witter, Discover & Co. acquired a fledgling San Francisco-based Internet discount broker, Lombard Brokerage. Dean Witter Lombard's. The Dean Witter deal for Lombard reportedly upset some of Witter's brokers, who were unhappy about going toe-to-toe with an affiliated discounter. Other full-service brokers, who have largely stayed back from online trading, were in 1997 looking at the use of client-broker e-mail as a tool to significantly improve productivity. An officer of Raymond James & Associates was quoted as saying that, while most full-service firms found electronic trading in complete opposition to their mission, "now we're not so sure." Addressing the annual conference of the Securities Industry Association in November, 1997, the chairman of IBM challenged the industry to move fully onto to the Net and asserted that firms with well-established names ran a risk of losing their advantage if they waited too long to enter cyberspace. Merrill Lynch indicated in late 1997 that it expected to offer electronic trading in early 1998.

Questions of how and when to monitor e-mail between brokers and clients have been a significant concern of the full-service securities firms in exploring the use of the Internet. Prudential Securities announced in 1997 a system of e-mail for its customers to send orders to its brokers, who would then arrange for execution or contact the customer. It also introduced a live internal e-mail network, in order to allow compliance personnel to review and archive e-mail in a paperless environment. New e-mail surveillance products were introduced that aimed at providing a practical way to filter and review e-mail for potential sales practice violations. Through the end of 1997, the New York Stock Exchange required that all electronic and written correspondence of registered representatives be reviewed before being sent. NASD members had to review such correspondence after it was sent. More liberal e-mail rules were proposed in 1997 by the New York Stock Exchange and the National Association of Securities Dealers. The changes were intended to allow firms like Prudential to review fewer e-mail messages, provided they establish certain compliance guidelines and employee educational programs. The SEC approved the rule proposals on December 31, 1997, effective February 15, 1998. As a result, supervisors at NYSE member firms are no longer compelled to review all e-mail messages by registered representatives before they can be sent to customers.

Security is a critical issue in the successful use of the Internet for issuance of securities secondary trading and furnishing of financial information. Of those full-service, full-commission brokerages which in late 1997 had Web sites to disseminate information about themselves and the stock market most had not yet begun to use the sites for trading. A perceived impediment to their entry into online trading was concern over security and over the ability of hackers to break into their computers and those of their customers. Software and systems developers as well as major brokerage firms have been making large investments to address security issues.

One security system developed for money management clients is marketed by Tradeware (www.tradeware.com). It is designed to encrypt the FIXlink product discussed earlier (subsection III.B.), using a U.S. Government data encryption standard. Brokers using FIX software will also have available to them a more sophisticated encryption method developed by Morgan Stanley.

Vincent Catalaneo, President of the New York Society of Securities Analysts, sees extranets as the next major step in the financial services industry and believes they will help reduce concerns over security. As institutions and the brokerage community become more comfortable with the encryption technologies, it will further spur the increase in web-based transactions.

B. Institutional Trading on the Internet.

Large institutional investors have used electronic trading among themselves since the 1970s. Instinet (www.instinet.com) introduced a closed networked computer system in which a group of institutional members could trade electronically among themselves, thereby avoiding brokers in the middle. As a professional stock trading system used by institutions (mutual funds, broker-dealers, etc.) to trade large blocks of stock with each other outside of the established stock exchanges, Instinet does not use the World Wide Web. Its members use a more limited electronic linking system that is essentially an "extranet." Their trades are made on an anonymous basis, directly between buyer and seller. In the past few years, other closed electronic services have started operating, such as the Island System and the Portfolio System for Institutional Trading ("POSIT"). While Instinet operates simply by electronically "hitting" offers posted in an electronic order book, POSIT uses a crossing system for batches of orders. Despite the fact that these alternative systems are limited to institutions, their volume of trading has greatly escalated; the SEC estimated in 1997 that they handled almost 20% of the orders in Nasdaq securities and almost 4% in New York Stock Exchange-listed securities.

There is no barrier to adapting the private network approach trading from existing extranets to the World Wide Web, provided that security and reliability issues can be successfully resolved. Once these issues are resolved, institutions may move to privately-accessed Web sites that will function similarly to Instinet trading. One software protocol claiming to have sufficient security to allow institutional broker-dealers to trade electronically with one another via the web is Financial Information Exchange ("FIX"), which provides a service called "FIXLink." FIXLink operates on a site (www.tradeware.com) where subscribing money managers can receive brokers' indications of interest, post-trade advertisements and brokers' reports of block-trade fills in FIX protocol over the World Wide Web. Subscribing broker-dealers can send the same kinds of information to targeted institutional customers or all the institutional participants.

Other institutional trading systems using the Web on a password-protected basis include a site operated by Daiwa Securities America for debt instruments: "The Odd-Lot Machine" (www.oddlot.com/). Daiwa's site allows institutions to trade electronically in U.S. Treasury bills (up to $10 million), note and bonds ($3 to $5 million, depending on duration) and strips. Institutional customers can accept the posted prices or enter their own bids by just clicking to the site. Interdealer trading in municipal bonds is also available through a Vermont dealer's web page, using a process of trading similar to the traditional system, except that the offers and bid occur in cyberspace--on the Web site--rather than by telephone and fax machine.

A number of firms have been building Internet trading capabilities to enable online transactions in fixed-income securities. As electronic trading in bonds over the Internet becomes increasingly accessible not just to large institutions but also to high net worth retail traders, we may anticipate increasing competition in the bond marketplace.

C. Clearing, Back Office Operations and Market Data.

Internet services available to broker-dealers are not limited to institutional sales or retail activities. Many broker-dealers do not handle the execution or clearing of their customer's transactions or other "back-office" functions, but instead have them handled by clearing firms. Over the past few years, clearing firms have sought to position themselves to offer clearing services via the Internet. PaineWebber's Correspondent Services Corp. for example, provides execution and clearing services for about 125 correspondent firms. It has developed an Internet information delivery system which offers account access, market data and other services to retail customers of U.S. correspondent firms, which in turn receive account information, online forms and broker order entry over the Internet. Since late 1996, Pershing, National Financial Services Corp., BHC Securities and other clearing firms unveiled Internet services that will allow retail brokerage firms and their customers the ability to access account information, market data, research and news, as well as to execute trades.

U.S. Clearing Corp. ("USCC"), a large clearing and execution firm, in April, 1997 announced a jointly-operated Internet service with Ernst & Co. for discount brokers that, among other things, would provide access to a database of 6,000 mutual funds. USCC also introduced an Internet securities tracking system in 1996 through an affiliated discount broker, Quick & Reilly, Inc. In late 1997, E*Trade began to offer its clients online access to mutual fund prospectus covering more than 4,000 funds. The system, developed by InUnity Corp., eliminates delays traditionally experienced in obtaining hard copies of fund prospectuses. The kinds of services that can be made available are endless, and could enable smaller broker-dealers to offer a much greater array of financial services and products than they have been able to previously.

D. Bulletin Boards, Message Groups and Secondary Trading on the Web.

Assuming a small issuer successfully completes an online DPO, its securities may not become eligible for trading on Nasdaq or even in the over-the-counter ("OTC") market

maintained by broker-dealers. As a practical matter, broker-dealers will not actively make a market in a security if the issuer is not registered with the SEC under Section 12(g) of the 1934 Act and filing periodic reports required by that statute. Registration under the 1934 Act is only required when an issuer has at least 500 recordholders of a class of its securities and at least $10 million in assets. Because of the small size of DPOs and the issuers that use them, 1934 Act registration of the issuers is therefore generally not mandated. Newly-issued securities will not qualify for listing on Nasdaq unless the issuer meets Nasdaq requirements, such as minimum per share bid price, minimum public "float" (i.e., proportion of shares owned by the public) minimum market value, total assets, total equity and number of shareholders.

For a DPO issuer, the World Wide Web offers bulletin board trading as an alternative (or, in some cases, a supplement) to trading on Nasdaq or in the OTC market. On a Web bulletin board, potential buyers and sellers can post bids and offers and contact each other to facilitate transactions. Bulletin boards started with issuers who had made DPOs and sought to facilitate secondary trading. Spring Street Brewing was perhaps the first to attempt a bulletin board for its issued securities, but its early encounter with SEC problems ultimately led its promoter, Wit Capital, to move away from the bulleting board and instead become a licensed broker-dealer and undertake to help other issuers establish online markets.

One of the early boards was that of "Real Goods `Off-the Grind' Trading System," operated by Real Goods at www.realgoods.com. Real Goods, which issued the stock traded on the board, markets environmentally-oriented consumer goods such as energy-saving appliances. It obtained the SEC's first no-action letter authorizing a Web site bulletin board in 1996, allowing it to operate a Web page for trading in its own shares. The SEC stated that Real Goods could operate the site without registering as a broker-dealer or investment adviser, on the condition that Real Goods would play no role in effecting any transaction, receive no compensation for creating and maintaining the system, not receive, transfer or hold funds or securities in connection with operating the system, put disclaimers on the site regarding any registered status, keep records of all quotes entered, and inform users of the applicability of securities laws to offers and sale.

Other issuers who proposed their own passive bulletin boards for prospective buyers and sellers of their common stock obtained similar no-action letters from the SEC. Thus, "PerfectData Corporation" (www.perfectdata.com/), like Real Goods, is a DPO issuer that provides a bulletin board for secondary trades only in its own stock. This is accomplished in a subsite called "PerfecTrade," where potential buyers and sellers can post offers to buy or sell and then contact each other to facilitate transactions in PerfectData common stock. PerfecTrade's business is operating an Internet service provider. Like Real Goods, it does not charge any commissions or transaction fees, and its site contains recent trading activity and stock quotations on PerfectData common. The Flamemaster Corporation received an SEC no-action letter for a parallel operation.

In contrast to the foregoing bulletin boards, which involve trading solely in the operator's own outstanding stock, a company named Internet Capital Corporation ("ICC 2,"

unrelated to ICC 1 discussed earlier in Section II) proposed in late 1997 to operate a bulletin board to cover trading in other issuers' stock. It sought a no-action letter from the SEC authorizing it to operate a "passive" bulletin board without being required to register as a broker-dealer, investment adviser or national securities exchange. ICC 2 proposed that its bulletin board would only be available to companies whose common stock is either already registered under Section 12 of the 1934 Act or who file supplemental periodic information and reports in accordance with Section 15(d) of that Act.

ICC 2's Web site would, in addition to the bulletin board, provide access to each company's public SEC filings by hyperlinks to the SEC's EDGAR database, a brief summary of information from the company's SEC Form 10-K, a directory of all of the companies that are listed on an organized exchange such as the New York Stock Exchange or NASDAQ, and a periodic ICC 2 newsletter. ICC 2 would charge each company on its site a one-time fee for setting up its information and a monthly fee for maintaining its information. Importantly, neither ICC 2 nor any affiliate was to receive any compensation in connection with the purchase and sale of any common stock listed on its bulletin board. Its monthly fees to the listed issuers would not be related to the number or size of the quotes, expressions of interest or "hits" on a company's information page. However, ICC 2 would reserve the right to require viewers in the future to pay a one-time fee upon their initial registration as a site participant. No transaction would be effected on the bulletin board itself. Instead, the board would give participants (1) the names, addresses and telephone numbers (or other contacts, such as e-mail) of all interested buyers and sellers, (2) the number of shares to be involved in a trade, (3) whether the participant is a prospective buyer or seller, (4) the proposed price, and (5) the date on which the information will be deleted from the bulletin board. The trades would all be effected only by direct contract between participants, and ICC 2 would not maintain transaction records. Neither ICC 2 nor any affiliate would (1) be involved in any purchase or sale negotiations, (2) give any advice on the merit of any trade, (3) use the bulletin board to offer to buy or sell securities, (4) receive, transfer or hold funds or securities as an incident of operating the bulletin board, or (5) directly or indirectly facilitate the clearance or settlement of any securities transactions except to refer participants to a bank.

Among various notifications and disclaimers that ICC proposed to include on the site were these:

(1) a disclaimer that ICC 2 is a registered broker-dealer or securities exchange;

(2) a prohibition against "two-sided quotes," in which a person indicates both a bid at one price and an offer at a higher price;

(3) a disclaimer that the bulletin board postings are firm offers or quotes or that ICC 2 warrants any of the posted information;

(4) a warning that the registration requirements of the federal securities laws apply to all offers and sales through the bulletin board, hence each participants must ascertain the availability of an applicable exemption from registration.

In issuing its no-action letter allowing the foregoing method of operation to go forward, the SEC advised that it would not require ICC 2 to register under the 1934 Act as a national securities exchange or as a broker-dealer. In a second letter in January 1998, the SEC also advised that it would not require ICC to register as an investment adviser under Section 203(a) of the Investment Advisers Act of 1940.

E. State Regulation of Broker-Dealers and Investment Advisers on the Web.

The fact that communications posted on the World Wide Web are accessible to anyone with a personal computer and an Internet service provider raises jurisdictional questions as to how state blue-sky laws should apply to secondary trading. These issues are discussed in more detail in Section V.B below. However, a practical approach to the issue was adopted in 1997 by the North American Securities Administrators Association (NASAA): a policy regarding the use by broker-dealers and investment advisers of the Internet to describe available products and services. NASAA's policy exempts from the definition of "transacting business" within a state for purposes of Sections 201(a) and 201(c) of the Uniform Securities Act those communications by out-of-state broker-dealers, investment advisers, agents and representatives that involve generalized information about products and services where it is clearly stated that the person may only transact business in the state if first registered or otherwise exempted, where the person does not attempt to effect transactions in securities or render personalized investment advice, uses "firewalls" against directed communications, and also uses specified legends. NASAA's approach should facilitate the use of the Web by those smaller or regional securities professionals who focus their activities in a limited geographical area.

IV. The Internet As an Information and Services Tool.

Knowledge is power in the field of investing. Because the Internet expands the individual investor's access to vast amounts of information at tremendous speed, it has become an empowering tool. It has also become an effective method for investment product providers to maintain and initiate relationships with customers.

A. Use by Mutual Funds to Offer Services and Disseminate Information.

Mutual funds use the Internet in multiple ways, offering investment services and distributing information of all kinds. For example, Fidelity Investments not only offers funds and brokerage at its regular Web site (www.fidelity.com), but also operates an Internet 'zine called "@82 Dev." The Fidelity Web site featured a streaming worldwide stock ticker, research, fund descriptions, customized stock quotations, and online trading.

Visitors to "@82 Dev" (named after Fidelity's Boston address) can find book reviews, discussions by Fidelity investment managers, plus the streaming stock ticker. The "Charles Schwab Mutual Fund OneSource" subsite on the Charles Schwab homepage (www. Schwab.com) offers descriptions of a myriad of fund products and services, comparisons, trading and portfolio design. For online market information, the viewer accesses a sub-site, called "Market Buzz." Schwab in 1997 began marketing its capacity for processing fund supermarkets and wrap programs offered by other broker-dealers and by banks. By the time it landed its first major contract to clear funds for another brokerage firm, Schwab was handling more than 45,000 no-load fund transactions a day and had more than $100 billion in third-party no-load funds.

American Express Financial Services (www.americanexpress.com/direct/index__b.html), Vanguard Funds (www.vanguard.com) and many other mutual funds have similarly gone on the Internet. Two of the largest firms servicing mutual fund shareholders set up Internet-based transaction systems in 1997 for shareholders of their fund clients. First Data Investor Services Corp. in Massachusetts and DST Systems in Kansas City began offering both Internet Services in 1997. These services allow shareholders in one of a family of mutual funds having the same investment manager to exchange shares among funds in the same family. They can also access account balances and transaction histories and portfolio listings on much the same way as shareholders of Fidelity. Subsequently, a competitor, SunGard Trust and Shareholders Systems, announced that it would unveil a similar Net-based system in 1998. As a result, viewers can find an almost endless array of news and information, different financial products and opportunities online investing.

B. Sites Offering Individual Investors News, Research and Analysis.

Not long ago, sophisticated investment research tools were available only to institutions and securities professionals. Now almost any investor can become his or her own securities analyst by using free or low-cost websites which contain enormous quantities of data and sophisticated tools that help to identify and screen securities and design portfolios. By September 1997, the number of such stock-screening sites on the Web had risen in just a year from zero to 15. For example, at Quicken Networth (www.networth.quicken. com), an individual investor can sort through some 12,000 different stocks for 19 different variables, including rates of growth in earnings or sales, or amount of insider trading. Another free stock screening site, Hoover's Stockscreener (www.stockscreener.com), displayed only 8,000 stocks, but they could be screened for 22 variables with the results presented in spread-sheet form.

Other sites, while not free, still fall within the reach of most investors. For example, "Microsoft Investor" (investor.msn.com/home.asp) which charges $9.95 a month, has an "Investment Finder" program that can evaluate a universe of 8,000 companies according to 81 different criteria. If the viewer asks for stocks to be rated by "price ratios," the "Finder" offers five subcriteria: price to book value; price to earnings, either currently or on several historical bases; and price to sales. Finder's criteria can be set as high or low as possible, and the 25 stocks that best fit the criteria will be presented in chart form. Perhaps the richest trove of data among these sites is "Wall Street City"

(www.wallstreetcity.com). At $34.94 per month, this analytic tool can tap into as many as 40,000 stocks (including foreign issues) using 297 different variables.

Other sites offer the viewer or mix of market information, financial data and more general news, including sports and forums. An example is Bloomberg Online (www.bloomberg.com), which offers a 24-hour-a-day worldwide financial information network. A site featuring information solely about equity securities is The Motley Fool (www.fool.com). Along with articles on investing strategies, it displays model portfolios, ideas on specific stocks, message boards and allows viewers to share information on stocks. A viewer can find links to over a thousand finance-related sites listed at The Syndicate (www.moneypages.com/syndicate). Zacks has a collection that includes stocks, mutual funds and all kinds of material on personal finance at iw.zacks.com. Another example of such a "facilitator" is at www.natcorp.com, a Web page operated by "National Corporate Services, Inc." It features links to stock exchanges, self-regulatory organizations, issuer Web sites and other financial news.

Investors are able to use special online services to receive information from issuers. An issuer posts financial information and news on its own Web site, and then expands the universe of potential readers by links to a service provider such as Reality Online. Reality Online, which operates "Inc.Link," can generate up to 25 pages of enhanced financial content for a given issuer's Web site. Inc.Link will then link the issuer's Web site to a detailed profile of the issuer posted at 110 "hub" sites, which are mostly brokerage firms home pages. Thus, an investor is able to move from a profile of an issuer located at a brokerage site to the issuer's site where there is different material generated by Reality Online, or in reverse order.

Hyperlinks are widely-used devices to enhance a Web site. Just as Microsoft offers its viewers links to online brokerage firms, brokerage firms frequently link to research reports. In order to shield the linking firm from misleading information on someone else's Web site, disclaimers can be installed. Once a user accepts the conditions of the disclaimer, the referring site keeps a record of the agreement. An example is the disclaimer by National Discount Brokers at its Web site (www.NDB.com). National also uses tracking devices called "cookies" which monitor how often a given site to which it has a link is visited.

Moreover, other tools can be integrated with financial analysis and execution software. For example, the software maker Intuit, which publishes the most widely-used personal financial management program, has formed online partnerships with a number of brokerage firms so that investors can download brokage account and market information into their personal financial program. According to former SEC Commissioner Richard Roberts, electronic trading by individuals on NASDAQ will "increase exponentially for the foreseeable future." Access to Nasdaq's Small Order Execution System ("SOES"), coupled with the enormous amounts of information available instantly online at little or no cost, gives retail customers the ability to trade electronically with the kind of information that historically was enjoyed only by institutions.

Such online tools and data bases are not only tending to level the playing field between big and small investment professionals, but between investment professionals and dedicated amateurs as well. Many sites, particularly Microsoft Investor, are easy for the amateur to use and offer amazing speed. In view of the accelerating speed and power of the Internet, it is hardly fanciful to project that a bright high-schooler in 2001 A.D. will be better equipped from the standpoint of data and tools to analyze securities than a professional was just a few years ago.

V. Internet Securities and the Jurisdiction Reach of Securities Laws.

A. Background: Basic Jurisdictional Principles under the U.S. Constitution and under International Law.

In exploring the new jurisdictional issues posed by issuing and trading of securities on the Internet, it is useful to review briefly the principles of personal jurisdiction that antedate this new medium. Traditionally, there have been two types of personal jurisdiction under U.S. law, "general" and "specific." General jurisdiction is of less immediate importance to Internet transactions and involves a nonresident defendant whose contacts with the forum state are unrelated to the particular dispute in issue. The criteria for application of general jurisdiction under constitutional due process limitations are very strict; such jurisdiction can apply only if the defendant's contacts with the forum are "systematic" and "continuous" enough that the defendant might anticipate defending any type of claim there. Given the strict requirements, it is not surprising that to date no finding of general jurisdiction has been based solely on advertising on the Internet.

Specific jurisdiction applies where the defendant's contacts with the forum state are related to the particular dispute in issues. As stated in 1945 by the U.S. Supreme Court, personal jurisdiction over a non-resident defendant by a forum state requires only that "he have certain minimum contacts with it, such that the maintenance of the suit does not offend `traditional notions of fair play and substantial justice.'" Existence of the required "minimum contacts" is determined by a three-part test: (1) the defendant must purposefully direct his activities or consummate some transaction with the forum state or a resident thereof; or perform some act by which he purposefully avails himself of the privilege of conducting activities in the forum and thereby invokes the benefits and protections of its laws; (2) the claim must be one arising out of or relating to the defendant's forum-related activities; and (3) the exercise of jurisdiction must comport with "fair play and substantial justice," i.e., it must be reasonable.

An example of "purposeful direction" in the context of more traditional media was found where Florida residents wrote and edited an article in the National Enquirer which defamed a California resident. The Enquirer had its largest circulation in California and was the focal point of both the story and the harm suffered. These factors led the U.S. Supreme Court to conclude that there was sufficient evidence that the defendants' actions were "aimed at California" and would be expected to have a potentially devastating effect

on the California resident, hence the defendants could have reasonably foreseen being brought into court in California.

The test of "purposefully availing" oneself of the privilege of conducting business in the forum can be met if a party reaches beyond one state to "create continuing relationships and obligations with citizens of another state." For example, taken alone, a contract between a resident of the forum state and an out-of-state party may not establish sufficient minimum contacts to support personal jurisdiction, but added contacts such as telephone calls and mail into the forum state can collectively form a basis for jurisdiction over the nonresident.

International law similarly limits a country's authority to exercise jurisdiction in cases that involve interests or activities of non-residents. First, there must exist "jurisdiction to prescribe." If jurisdiction to prescribe exists, "jurisdiction to adjudicate" and, "jurisdiction to enforce" will be examined. The foregoing three types of jurisdiction are often interdependent and based on similar considerations.

"Jurisdiction to prescribe" means that the substantive laws of the forum country are applicable to the particular persons and circumstances. Simply stated, a country has jurisdiction to prescribe law with respect to: (1) conduct that, wholly or in substantial part, takes place within its territory; (2) the status of persons, or interests in things, present within its territory; (3) conduct outside its territory that has or is intended to have substantial effect within its territory; (4) the activities, interests, status, or relations of its nationals outside as well as within its territory; and (5) certain conduct outside its territory by persons who are not its nationals that is directed against the security of the country or against a limited class of other national interests.

Overarching the foregoing criteria is a general requirement of reasonableness. Thus, even when one of the foregoing bases of jurisdiction is present, a country may not exercise jurisdiction to prescribe law with respect to a person or activity having connection with another country if the exercise of jurisdiction is unreasonable. The net effect of the reasonableness standard is to require more close contact between a foreign defendant and the forum country than is required under constitutional due process.

B. Conflict Between the Internet and Jurisdictional Boundaries.

The principles of jurisdiction just discussed are made more difficult to apply to jurisdictional issues on the Internet, despite its decentralized structure. Information over the Internet passes through a network of networks, some linked to other computers or networks, some not. Not only can messages between and among computers travel along much different routes, but "packet switching" communication protocols allow individual messages to be subdivided into smaller "packets" which are then sent independently to a destination where they are automatically reassembled by the receiving computer. Since the Internet is indifferent to the actual location of computers between which information is routed, there is no necessary connection between an Internet address and a physical jurisdiction. Moreover, Web sites can be interconnected, regardless of location, by the

use of hyperlinks. Information that arrives on a Web site within a given jurisdiction may flow from a linked site entirely outside that jurisdiction. Finally, notwithstanding the Internet's complex structure, the Internet is predominately a passive system. In other words, Internet communication only occurs when it is initiated by a user.

C. Applying U.S. Constitutional Principles to Internet Jurisdiction.

Precedents from print, telephone and radio media generate analogies that can be useful in determining whether jurisdiction over Internet activities offends constitutional due process. For example, if an Internet-based news service were to send a number of messages specifically addressed to residents of a forum, there would be "purposeful direction." Such purposeful direction can exist even though, unlike the physical shipment of substantial numbers of copies of the National Enquirer into California, from which the newspaper may be deemed to foresee an effect in that forum, nothing is shipped physically on the Internet. E-mail over the Internet is similar to traditional postal mail and to phone calls in this respect.

However, bulletin boards and Web sites are a step removed from e-mail. A person posting a bulletin board message knows that the message can be resent by others elsewhere in the world, but cannot control such redistribution. A Web site is even more of a passive medium; it sends nothing specifically directed to the forum state, but posts general information so that viewers can log on to the site. An analogy to the size of the National Enquirer's forum state circulation might be the number of hits on the Web site that emanate from the forum state. A site operator can identify the source of "hits" on his site; an operator of a Web site would therefore know whether a large proportion of the hits came from California. If information about a California resident were posted on the site, it could be argued under the National Enquirer rationale that the operator purposefully directed the information to California residents.

It is therefore unsurprising that decisions upholding the exercise of specific jurisdiction over a nonresident defendant by reason of using the Internet have typically been based on the defendant's purposeful availment of the privilege of doing business in the forum jurisdiction or the defendant's purposeful direction of electronic communications to the forum jurisdiction. When an Internet communication is directed into the forum for purposes of a transaction, personal jurisdiction based on more traditional means such as mail or telephone can be invoked to determine that the defendant is electing to do business there. By the same token, if the Web site operator intends to receive communications emanating from the forum state in response to a Web posting and actually does, he avails himself of the privilege of doing business there. In one case, for example, a non-resident of California allegedly operated a scheme consisting of registering exclusive Internet domain names for his own use that contained registered trademarks. The defendant allegedly demanded fees from a California resident and other businesses that asked him to discontinue his unauthorized use of their trademarks. A federal district court held that it had personal jurisdiction over the defendant by the defendant's having committed a tort "expressly aimed" at California. It reasoned that the

defendant could foresee the harm done in California and therefore satisfied the minimum contact requirement.

In another case, the defendant registered an Internet address, which contained the plaintiff's trademark as its own. The plaintiff then sued for violation of his trademark. A Connecticut federal court found the out-of-state defendant subject to its jurisdiction because its Internet advertising could be accessed in Connecticut. The advertising on the Internet was found to be "solicitation of a sufficient[ly] repetitive nature to satisfy" the requirements of Connecticut's long-arm statute, which confers jurisdiction over foreign corporations on a claim arising out of any business in Connecticut. The court also held that the minimum contact test of the due process clause of the Fourteenth Amendment was satisfied, because the defendant had purposefully "availed" himself of the privilege of doing business in Connecticut in directing its advertising and phone number to the state where some 10,000 subscribers could access the Web site.

Constitutional due process allows potential defendants to structure their conduct in a way to avoid the forum state. However, to assume that a Web site operator can entirely avoid a given jurisdiction is unrealistic. Because the Web overflows all boundaries, the only way to avoid any contact whatsoever with a specific jurisdiction would be to stay off the Internet. For that reason, mere accessibility of a Web site should not properly be deemed to satisfy the Fourteenth Amendment minimum contacts requirements. Site operators should be able to structure their site use to avoid a given state's jurisdiction. As described below, this reality has been recognized by regulators in the United States under both state blue-sky statutes and federal securities laws.

D. Jurisdiction of Blue-Sky Laws Over Internet Transactions.

As discussed in subsection II.C.2.a. above, the Uniform Securities Act applies a state's jurisdictional reach to persons offering to buy or sell securities "in [a given] . . . state." In fact, the constitutionally permissible reach of a state's in personam jurisdiction is even broader than those words suggest. Under a typical long-arm statute, even if a defendant does not have substantial or continuous activities within a State, personal jurisdiction can still be based on purposeful direction of activities toward the State.

The USA tightens the jurisdictional inquiry by providing that an offer to sell or buy is made "in this state, whether or not either party is then present in this state, when the offer (1) originates from this state or (2) is directed by the offeror to this state and received at the place to which it is directed . . . ." Whether an Internet offer "originates" from a given state should not be based on the physical location of the essentially passive circuits carrying the message. Regardless of the multiplicity of networks and computers that an electronic message may traverse, the place where information is entered into a Web site or into e-mail is the point of origination.

Whether an Internet-based offer to buy or sell is "directed" into a given state is a more complex factual inquiry. If an offer to sell securities were mailed or communicated by telephone to a person in a forum state, personal jurisdiction in that state should apply. By

like token, an e-mail offer by Internet directly to the a resident of a state would similarly constitute a basis for jurisdiction in that state. So would acceptance by an out-of-state issuer of an e-mail from person in the forum state, subscribing to a general offering posted on the World Wide Web. However, mere posting of the existence of an offering on the World Wide Web, without more, is different. Standing alone, it constitutes insufficient evidence that the offer is specifically "directed" to persons in every state. The offer may, indeed, not be intended to be accepted by persons in certain states.

In order to reconcile technology, practicality and due process concerns, the North American Securities Administrators Association (NASAA) adopted a model rule to clarify jurisdiction over Web-based securities offerings. Under the NASAA policy, states will generally not attempt to assert jurisdiction over an offering if the Web site contains a disclaimer essentially stating that no offers or sales are being made to any resident of that state, the site excludes such residents from access to the purchasing screens and in fact no sales are made to residents of that state.

As of January 1998, 32 states had adopted the NASAA safe-harbor, either by statute, regulation, interpretation or no-action letter. Commonly, the disclaimer is contained in a page linked to the home page of the offering. In late 1997 the Arizona Corporation Commissioner proposed a stricter version which would require that the disclaimer be placed on the home page, rather than through hypertext links. A preferred technique is to request entry of the viewer's address and ZIP code before the viewer is allowed to access the offering materials. If the viewer resides in a state in which the offering has not been qualified, access is denied. Of course, the viewer might choose to lie, but it can be argued with some logic that a Website operator cannot reasonably "foresee" that viewers would lie.

E. Jurisdiction of U.S. Securities Laws Over Foreign Sites.

The federal regulators in 1998 articulated an approach that resembles that of NASAA, although in the context of a broader statutory scheme. The basis of 1933 Act jurisdiction is use of "any means or instruments . . . of communication in interstate commerce" to sell securities that are not either registered or exempt from registration. 1934 Act jurisdiction applies to any broker or dealer (including any foreign broker or dealer), who makes use of any "instrumentality of interstate commerce to effect transactions in, or induce or attempt to induce the purchase or sale" of any security an instrument of communication in interstate commerce, the issue determining application of the federal securities laws is whether the off-shore resident is using that instrument simply by posting on the World Wide Web.

The SEC has in the past interpreted the 1934 Act broadly, so as to require an off-shore broker or dealer to register under that Act where its only U.S. activity is execution of unsolicited orders from persons in the U.S. This interpretation is not inconsistent with either concepts of due process or international law. It will be recalled that, under international law, a country may assert jurisdiction over a non-resident where the assertion of jurisdiction would be reasonable. The standards include, among others,

whether the non-resident carried on activity in the country only in respect of such activity, or whether the non-resident carried on, outside the country, an activity having a substantial, direct, and foreseeable effect within the country with respect to such activity. Under these rules, a court in one country could assert jurisdiction over a foreign company under the "doing business" or "substantial and foreseeable effects" tests where financial information is directed by e-mail into the country. The accessibility of a Web site to residents of a particular country might also be considered sufficient to assert personal jurisdiction over an individual or company running the Web site.

In 1998, the SEC issued an interpretive release on the application of federal securities laws to offshore Internet offers and transactions. The SEC's release sought to "clarify when the posting of offering or solicitation materials" on Web Sites would not be deemed activity taking place in the United States for purposes of federal securities laws. The SEC adopted a rationale that resembles that used by the NASAA in determining the application of state blue-sky laws.

Thus, the SEC generally will not consider an offshore Internet offer made by a non-U.S. offeror as targeted at the U.S. if (1) the Web site includes a prominent disclaimer making clear that the offer is directed only to countries other than the U.S., and (2) the Web site offeror implements procedures that are "reasonably designed to guard against sales to U.S. persons in the offshore offering."156A For example, the offeror could ascertain the purchaser's residence by obtaining the purchaser's mailing address or telephone number (including area code) before sale. If the offshore party receives indications that the purchaser is a U.S. resident, such as U.S. taxpayer identification number or payment drawn on a U.S. bank, then the party is on notice that additional steps need to be taken to verify that a U.S. resident is not involved. Offshore offerors who use third-party Web services to post offering materials are subject to similar precautions, and also may have to install additional precautions if the third-party Web site issued to generate interest in the offering. For example, using a third-party site that has a significant number of U.S. subscribers or clients would require the offeror to limit access to the materials to those who could demonstrate that they are not U.S. residents.

NOTE: THIS IS FOOTNOTE 156 & 156A IN "SUPERSCRIPT" FONT SIZE. PER DTR'S REQUEST TO CREATE A FOOTNOTE 156A AND IT WILL APPEAR INSIDE FOOTNOTE NO. 156 IN "SUPERSCRIPT" FONT SIZE WITH TEXT. kar 4/1/98.

If the off-shore offering is made by a U.S. issuer, stricter measures would be required. The U.S. residents can obtain access to the offer. If offerings are made by a foreign investment company, similar precautions must be taken not to target U.S. persons in order to avoid registration and regulations under the 1940 Act. When an offer is made offshore on the Internet and with a concurrent private offer in the U.S., the offeror must guard against indirectly using the Internet offer to stimulate participants in the private U.S. offer.

Notwithstanding federal securities laws, U.S. investors can log on freely to off-shore cybersecurities sites, since there are no technological barriers to prevent an American from investing directly via the Internet in the securities of a foreign issuer at a foreign site. For example, U.S. viewers in 1997 could access the site of the first Australian DPO, Linear Energy Corporation Limited (www.linearenergy.com.au). The Australian company claimed to have developed an engine using compressed air to generate electricity. However, a U.S. viewer could not access the offering document without making a misrepresentation, because the Australian Securities Commission required that a viewer first confirm residence in Australia on the screen as a condition of accessing the prospectus.

Not all offshore issuers will show the restraint of the Australians, which raises the practical question as to how the SEC or state regulations will be able to police offerings to U.S. residents. Despite difficult practical issues facing the SEC in such regulation, it intends to try. The SEC has stated that it might attempt to regulate entities that "provide U.S. investors with the technological capability to trade directly on a foreign market's facilities," which could be construed to embrace any U.S. internet service provider or any U.S. Web site with a link to a foreign stock exchange or bulletin board.

The SEC has on a number of occasions taken steps to enforce the federal statutes with respect to the Internet. For instance, several offshore Internet sites who were not as fastidious as Australia's Linear Energy encountered problems with the SEC. A viewer could in early 1997 click to "FreeMarket" at www.freemarket.org/. The viewer could not have advanced much beyond the home page, which advised that "[a]t the demand of the United States Securities and Exchange Commission, FreeMarket Foundation will discontinue operations immediately." Contending that "FreeMarket was founded upon the central tenet of America that everyone is free to transact business." FreeMarket said that the SEC was "killing" its dream of allowing companies to establish a secondary market for their own shares on the Internet. What was needed, said FreeMarket, was "an unfettered flow of ideas on the Internet," because "[i]t is unlikely that an Internet surfer will be scammed the same way a person receiving a telephone solicitation will." The SEC apparently saw things differently, since Freemarket went off its Web site after February 1997. By June 1997, the domain name and address had been acquired by WinNET, a web hosting and design firm having no activity in the securities business.

As late as early June 1997 a Web surfer still might have accessed another foreign Web site, "Offshore Capital Resources" (www.ocr-ltd.bs/). Offshore Capital claimed to be a Bahamian International Business Corporation all of whose operations and all of whose transactions were outside the U.S. It was offering, through what it called an "Offshore Placement Memorandum," shares of its common stock. The SEC also ordered this site to discontinue operations immediately, with the termination notice to be posted until June 30, 1997. Offshore Capital apologized on the screen that "[w]e won't be able to continue with this leading-edge investment concept," because the SEC wanted assurance that U.S. citizens would not participate in the transactions. By late 1997, its Web address was blank.

The SEC has used U.S. federal courts to bring proceedings against foreign-based securities sellers. For example, on May 28, 1997 the United States District Court of the District of Columbia permanently enjoined Wye Resources (in a default judgment) from violating U.S. securities laws. Wye, a Canadian corporation, claimed to own mining interests but had no recorded mining earnings. Wye also allegedly issued false press releases and public information. The default nature of the proceeding meant that the jurisdictional issue went uncontested, probably because Wye's former President had earlier consented to a permanent injunction against him in the same action. Similarly, the SEC took the default of a German resident obtained a permanent injunction against her, together with a court order that she pay more than $9.3 million in penalties. She had used the Internet to solicit U.S. investors in building a fraudulent prime bank scheme.

Because the World Wide Web is a borderless new medium, it is too early to predict a logical worldwide regulatory scheme. Assumably, regulators in the economically advanced nations will try to establish coordination agreements to help enforce antifraud laws. Moreover, they may try to use the Internet as a tool against its abusers by posting and publicizing on the Web the identities of suspected abusers. It is also conceivable that sophisticated electronic screening mechanisms will be developed which would allow regulatory agencies to block or impede the transfer into the United States of offering materials that avoid compliance with U.S. registration requirements.

VI. Conclusion.

Digital communication and electronic commerce are still in their infancy. The ultimate impacts they will have on public offerings, secondary trading and capital formation are impossible to predict so early in their evolution. A few things are clear. First, big and small issuers can reach more potential investors faster, reducing the advantages of intermediaries. Second, smaller financial institutions have instant access to vast amounts of complex financial data, creating a leveling influence. Third, despite a more level playing field in terms of information access and outreach to viewers, the sheer volume of people, places and data on the World Wide Web may ultimately spur midsized non-niche operators to combine. It remains to be seen whether the cost to build software systems that will allow for larger and more sophisticated securities offerings in the future will be so substantial that it will limit the number of "players." Fourth, because of the global and instantaneous nature of the World Wide Web, jurisdictional barriers are more vulnerable than ever. Finally, the individual investor will be increasingly empowered by access to types of information previously available to only large institutions. By the year 2000, the landscape of corporate finance will have changed dramatically from what existed as recently as two years ago.

END